Office - Supreme Court, U.S.
FILED
NOV 8 1982
ALEXANDER L. STEVAS,
CLERK

No. 82-467

IN THE

Supreme Court of the United States

October Term, 1982

SPLIT ROCK NURSING HOME,

Petitioner,

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Management,

Respondents.

Respondents' Brief in Opposition to Petition for a Writ of Certiorari

ROBERT ABRAMS
Attorney General of the State of New York, Attorney for Respondents
The Capitol
Albany, NY 12224
(518) 474-7154

PETER H. SCHIFF
Acting Attorney in Chief
Appeals and Opinions
State of New York

ALAN W. RUBENSTEIN
Assistant Attorney General
State of New York
Of Counsel

Counterstatement of Questions Presented.

1. Whether the question presented by petitioners was raised in the New York Courts.

2. Whether the due process clause of the Fourteenth Amendment is violated where, as here, a State administrative agency applies broad regulatory language to a specific factual situation as it arises.

Table of Contents.

	Page
Counterstatement of Questions Presented	i
Table of Contents	ii
Table of Authorities	iii
Preliminary	1
New York Regulation Involved	2
Statement of the Case	2
Reasons for Denying Certiorari	5
Conclusion	10
Appendix A. Petitioner's Brief at the New York Appellate Division	1a
Appendix B. Petitioner's Reply Brief at the New York Appellate Division	1b

TABLE OF AUTHORITIES.

Page

CASES CITED:

Blum v. Bacon ____ US ____, 102 S Ct 2355 at 2361 (1982) 7

Blum v. Yaretsky, ____ US ____, 102 S Ct 2777 at 2781 (1982) 7

Dept. of Mental Hygiene v. Kirchner, 380 US 194 (1965) 6

Durley v. Mayo, 351 US 277 at 281 (1956) 6

Matter of Cortlandt Nursing Care Center v. Whalen, 46 NY2d 979 (1979) 4, 6

Red Lion Broadcasting Co. v. FCC, 395 US 367 (1969) 7

Schweiker v. Hogan, ____ US ____, 102 S Ct 2597 at 2609 (1982) 7

Shea v. Vialpando, 416 US 251 at 262, n 11 (1974) .. 7

Stembridge v. Georgia, 343 US 541 at 547 (1952) ... 6

Udall v. Tallman, 380 US 1 (1964) 7

Page

STATUTES CITED:

United States Statute:

42 USC Title XIX, § 1396 *et seq*..... 3

New York Constitution:

Article I, § 6..... 6

New York Rules and Regulations:

"Medicaid," New York Social Services Law, § 363 *et seq*..... 2

New York Public Health Law:

Article 28..... 3

§ 2807(3)..... 7

10 Official Compilation Codes, Rules and Regulations of the State of New York, § 86.31..... 2

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1982

No. 82-467

SPLIT ROCK NURSING HOME,

Petitioner,

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Management,

Respondents.

Respondents' Brief in Opposition to Petition for a Writ of Certiorari.

Preliminary.

Petitioner offers but one reason why certiorari is warranted in this case which is premised upon a claim that "New York acted unconstitutionally when it seized [Medicaid] money paid to petitioner years earlier by giving retroactive effect to a new interpretation of its own [incentive allowance] regulation" (Pet, p 6). Our position as to

this is that there was no "seizure" nor was there a retroactive change in the interpretation of the incentive allowance regulation. Respondents merely applied broad regulatory language to a specific factual situation as it arose, i.e., the discovery, upon audit, that petitioner's return on equity had been enhanced by improperly using patients' personal monies to inflate its equity by including such monies as working capital.

New York Regulation Involved.

10 Official Compilation Codes, Rules and Regulations of the State of New York.

> "86.31 Incentive allowance; proprietary nursing homes. Within the rate of payment for proprietary nursing homes, an amount may be included as an allowable cost which is equal to a percentage established by the commissioner to represent a sharing in the amount by which the total costs of administrative, dietary and housekeeping services of an individual facility are lower than the weighted average* of the costs of these services for the group. In instances where the latest survey disclosed significant deficiencies in the operation of a facility, the incentive allowance will not be available." (Hereinafter 10 NYCRR § 86.31.)

The regulation was repealed October 14, 1975.

Statement of the Case.

Petitioner operates a proprietary nursing home in Bronx, New York and accepts patients whose cost of care is paid pursuant to the State's program of "Medical Assistance for Needy Persons" ("Medicaid", New York

*The section was added August 10, 1970, and amended August 17, 1971, to delete the word "ceiling" following "weighted average." The Petitioner has set out the regulation as first filed.

Social Services Law, §§ 363 *et seq.*; 42 USC Title XIX, §§ 1396 *et seq.*). The amount which petitioner receives for furnishing such care (its Medicaid reimbursement rate) is established pursuant to New York Public Health Law, Article 28 and applicable regulations.* The "incentive allowance" had been granted to petitioner pursuant to 10 NYCRR § 86.31 for the rate period effective July 1, 1972 through December 31, 1972 and, after a change in the fiscal year, from January 1, 1973 to December 31, 1973. It was disallowed after a regular audit of the facility's initial year operating costs incurred in 1971.

An administrative hearing was held to review several items which had been disallowed including the incentive allowance. The Hearing Officer had concluded that the "removal of the incentive allowance was improper and it should be restored" (Pet, p 30a). The director of the Office of Health Systems Management of the State Department of Health overruled that conclusion in his January 30, 1980 order (Pet, pp 8a, *et seq.*). He carefully reviewed the testimony of departmental personnel (pp 10a, 11a, 12a) and the regulation itself, including its 1975 repeal. He noted that the testimony showed that one aspect of losing the incentive allowance would be forefeiture if a facility was placed on the "significant operating deficiency list" (Pet, pp 10a, 12a) and that:

> "* * * However, § 86.31 speaks of significant deficiencies in the operation of a nursing home, which would include a broader scope of activity.

---

*Public Health Law, Article 28 regulations (which included § 86.31) are adopted and amended by the State Hospital Review and Planning Council, subject to the approval of the Commissioner of Health (Public Health Law, § 2803[2]).

> "In view of the Hearing Officer's finding of fact that in regard to Issue number 20 from the Notice of Hearing, that certain personal expenses of the operator and patients' personal monies were included in the working capital and hence the equity of the facility for reimbursement purposes, and upon audit disallowed, it is the Director's conclusion that the Respondent's action in so including them were significant deficiencies in the operation of the facility, as described in § 86.31. The use of patient monies to enhance one's return on equity by improperly using that money to inflate a nursing home's equity is not a proper use of the patient's personal monies. * * *" (Pet, p 12a)

He directed "[t]hat a rate of reimbursement be promulgated reflecting readjustments as per this Order" (Pet, p 19a).

The New York Appellate Division, Third Department, the court of first instance review, after stating that an agency interpretation of its own regulations is entitled to great weight and will be upheld if not irrational or unreasonable, rejected respondent's construction of the regulation as "not supported by any administrative precedent, written or otherwise" (85 AD2d 808, 809; 445 NYS2d 638 [3d Dept, 1981]).

The New York Court of Appeals reversed and reinstated the order of the Director of Health Systems Management as it pertains to petitioner's incentive allowance. It held that he "* * * did not act arbitrarily or unreasonably in this case in disallowing petitioner's incentive allowance for the years at issue. Accordingly, the determination of the Director must be sustained (*Matter of Cortlandt Nursing*

Care Center v. Whalen, 46 N.Y.2d 979)".* (56 NY2d 932, at 934; 453 NYS2d 680 [1982].)

Petitioner does not argue that it did not engage in an improper practice. Rather it asks this Court to raise a constitutional barrier between it and the application of the broad language of 10 NYCRR § 86.31 against it. This Court, we urge, should reject that invitation.

Reasons for Denying Certiorari.

A.

This proceeding was initiated in State Supreme Court pursuant to New York CPLR Article 78 to review the January 30, 1980 order which petitioner alleged to be, *inter alia*, arbitrary and capricious as well as an abuse of discretion. Its papers do not contain a claim of denial of due process of law or any constitutional claim. In its main brief in the New York Appellate Division, Third Department, it was stated, without argument or citation of authority, that:

> "In sum, the Health Department's determination to revoke Split Rock's incentive award retroactively is without a factual or legal basis and violates due process.* * *" (App. p. 16a).**

---

*In *Cortlandt Nursing Care Center*, the New York Court of Appeals stated (46 NY2d at 980):

> "* * * the commissioner's interpretation of a regulation is 'controlling and will not be disturbed in the absence of weighty reasons.' (*Matter of Sigety v. Ingraham*, 29 NY2d 110, 114.) Unless the commissioner's determination is arbitrary and capricious, it must be sustained. (*Severino v. Ingraham*, 44 NY2d 763, 764.)"

**We have printed petitioner's Brief and Reply Brief at the New York Appellate Division as an Appendix.

Neither the Appellate Division nor the Court of Appeals, which considered the matter summarily, spoke to due process. Petitioner's argument in State Court does not disclose whether his claim is grounded on Federal due process provisions or on the due process provisions of the Constitution of the State of New York (Article I, § 6. "* * * No person shall be deprived of life, liberty or property without due process of law"). Nor has petititioner obtained a certificate from the New York Court of Appeals as to which, if either, provision was considered (see *Dept. of Mental Hygiene v. Kirchner,* 380 US 194 [1965]). In these circumstances we urge that the Court lacks jurisdiction to hear and determine this matter (see *Stembridge v. Georgia,* 343 US 541 at 547 [1952]; *Durley v. Mayo,* 351 US 277 at 281 [1956] that "it must affirmatively appear from the record that the federal question was presented to the highest court of the State having jurisdiction").

B.

In holding that the Director of the Office of Health Systems Management did not act arbitrarily or unreasonably in this case in disallowing petitioner's incentive allowance for the years at issue, the New York Court of Appeals cited as authority its decision in *Matter of Cortlandt Nursing Care Center v. Whalen,* 46 NY2d 979 (1979). In that case, the Court held that the State Commissioner's interpretation of a regulation is "controlling and will not be disturbed in the absence of weighty reasons" unless the determination is arbitrary and capricious.

The New York Court of Appeals in its June 17, 1982 decision in the case at bar took care to limit its holding to "this case".* The Court did not characterize the State

*In which it had been discovered that petitioner's return on equity had been enhanced by improperly using patients' personal monies to inflate its equity by including such monies as working capital.

Commissioner's interpretation as a "new" interpretation, as petitioner suggests, or as an old interpretation. The Court, we urge, simply agreed with the State Commissioner, acting through his designee, that the broad regulatory language of section 86.31 applied to the specific factual situation presented by this case.

The statutory predicate to the State Commissioner's establishment of Medicaid reimbursement rates is found in New York Public Health Law, § 2807(3).* Pursuant to its terms the State Commissioner of Health, as to Medicaid reimbursement, must certify to the State Director of the Budget that the proposed rate schedules for payment of hospital and health related service "are reasonably related to the costs of efficient production of such service" (see *Blum v. Yaretsky*, ____ US ____, 102 S Ct 2777 at 2781 [1982]). This Court has recognized "* * * The sound principle of according deference * * * where the relevant statutory language is unclear or susceptible of differing interpretations" (*Shea v. Vialpando*, 416 US 251 at 262, n 11 [1974]). The New York Public Health Law, Article 28 statutory complex under which the State Commissioner functions in establishing Medicaid reimbursement rates is such a statute. We thus urge that this is precisely the type of case in which this Court would afford great weight to the State Commissioner's construction of his own regulations (see, e.g. *Red Lion Broadcasting Co. v. FCC*, 395 US 367 [1969], *Udall v. Tallman*, 380 US 1 [1964]). The Court has most recently reiterated that proposition in *Blum v. Bacon*, ____ US ____, 102 S Ct 2355 at 2361 (1982) and in *Schweiker v. Hogan*, ____ US ____, 102 S Ct 2597 at 2609 (1982).

---

*New York Laws of 1969, ch 957, § 4, effective May 26, 1969.

Removal of the incentive award after audit* was based upon the Hearing Officer's finding "that certain personal expenses of the operator and patients' personal monies were included in the working capital and hence the equity of the facility for reimbursement purposes" (Pet, p 12a). The Director of the Office of Health Systems Management concluded that "Respondents' [petitioners here] action [*sic*] in so including them were significant deficiencies in the operation of the facility, as described in § 86.31. The use of patient monies to enhance one's return on equity by improperly using that money to inflate a nursing home's equity is not a proper use of the patient's personal monies" *(idem.)*. What the State Commissioner held was that the nursing home was not entitled to an incentive award because it had engaged in an improper practice which was a significant deficiency in the operation of the facility. We urge that that holding was an altogether reasonable and rational interpretation by the Commissioner (through the Director, his designee) of his own regulation.

The decision and order of the New York Appellate Division which petitioner seeks to have reinstated seems to have been based, in large part, upon testimony of departmental employees at the administrative hearing. They, however, were not in policy-making positions and were not competent to testify concerning the policy of the Commissioner of Health. Indeed their testimony showed only that if a facility had been placed on a serious operating deficiencies list it would lose its incentive allowance. We

---

*Medicaid rates are fixed prospectively subject to periodic post-audit which can result in upward or downward adjustment of the original rate (see, e.g., *Solnick v. Whalen*, 49 NY2d 224, 425 NYS2d 68 [1980]; *Matter of Demisay v. Axelrod*, 87 AD2d 667, 448 NYS2d 834 [New York Appellate Division, 3d Dept. 1982], mot for lv to app den ____ NY2d ____ [1982]).

find no testimony, however, which would demonstrate that facilities that included patients' personal monies in working capital would be granted the allowance. The Commissioner's application of the regulation is fully consistent with its language. The Court need not and should not go behind its plain language.

The only issue in this case is the degree of deference which should be accorded to the interpretation and application of section 86.13 as manifested by the Director's January 30, 1980 order. The due process claim, mentioned by petitioner below as an aside, simply does not arise.

The "incentive award" had to be earned by a facility. That such an award has been denied to a facility that has overstated its equity account, as has petitioner, certainly does not shock one's sense of justice and fair play. 10 NYCRR § 86.31 has, we urge, been reasonably interpreted here so that petitioner will not be rewarded for its actions.

Finally, we again note that section 86.31 was repealed in 1975. A decision of this Court on the merits would thus have only limited significance.

CONCLUSION.

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Dated: Albany, New York
October 26th, 1982

Respectfully submitted,

ROBERT ABRAMS
Attorney General of the
State of New York
Attorney for Respondents

PETER H. SCHIFF
Acting Attorney in Chief
Appeals and Opinions,
State of New York

ALAN W. RUBENSTEIN
Assistant Attorney General
State of New York
of Counsel

APPENDIX A.—Petitioner's Brief.

Argued by
DAVID B. BERNFELD
(30 MINUTES REQUESTED)

NEW YORK SUPREME COURT

APPELLATE DIVISION—THIRD DEPARTMENT.

IN THE MATTER
of
The Application of SPLIT ROCK NURSING HOME,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Management,

Respondents.

PETITIONER'S BRIEF

HOFFINGER, FRIEDLAND & ROTH
Attorneys for Petitioner
10 East 53rd Street
New York, New York 10022
(212) 421-9040

JACK S. HOFFINGER
DAVID B. BERNFELD
ROBERT A. GOLDSCHLAG
Of Counsel

Table of Contents.

	Page
Preliminary Statement	3a
Introduction	4a
Background	4a
Issues raised	5a
The Evidence at the Hearing	7a
Incentive allowance	7a
Group averages versus 1971 costs	8a
POINT I. Split Rock Nursing Home was entitled to an incentive	9a
POINT II. Split Rock's reimbursement rate should have been based on group average	16a
Conclusion	20a
Statement Under Rule 5531 CPLR	21a

SUPREME COURT OF THE STATE OF NEW YORK

APPELLATE DIVISION—THIRD DEPARTMENT.

IN THE MATTER
of
The Application of SPLIT ROCK NURSING HOME,

Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Management,

Respondents.

Index No. 80-517

PETITIONER'S BRIEF

Preliminary Statement.

Split Rock Nursing Home petitions for a judgment pursuant to CPLR Article 78 annulling, vacating and setting

aside an order issued by the New York State Department of Health, dated January 30, 1980, after an administrative hearing, sustaining a reduction in the Medicaid reimbursement received by Split Rock Nursing Home.

These proceedings were transferred to this Court on May 14, 1980, by order of the Supreme Court, Albany County (Klein, J.) pursuant to CPLR 7804 (g).

Introduction.

Background.

Split Rock Nursing Home (petitioner) is a private proprietary nursing home located in the Bronx, New York. The expenses incurred in caring for Medicaid-eligible patients are reimbursed in accordance with federal and state statutes and rules promulgated by the New York State Department of Health (see generally, Title XIX of the Federal Social Security Act, 42 USC 1396 *et seq.*; Public Health Law §2807; Social Services Law §§ 363-368; 10 N.Y.C.R.R. Part 86).

Although the facility opened in 1971, its books and records for 1971 were not audited by the Health Department until 1974. Thereafter, based on that belated audit and without any prior hearing, the Health Department seized approximately $350,000 from the facility by withholding that amount from the reimbursement the home was entitled to receive in 1978.

Petitioner protested the determination which purportedly formed the basis for the seizure and requested a hearing. The protest and the request for a hearing were both summarily denied by the Department. A hearing was ultimately

held, however, pursuant to a court order obtained by petitioner. The hearing officer concluded that petitioner was entitled to approximately $90,000 of the amount in contention, but the Department refused to return even that, insisting on retaining all it had seized.

Issues raised.

Although there were numerous audit adjustments at issue in the administrative hearing, petitioner seeks review of only two issues:

> (a) approximately $90,000 in "incentive allowance" (which the hearing officer rules should have been returned to petitioner); and
>
> (b) whether the petitioner was entitled to reimbursement based on "group average" rather than "actual cost" (the Department insisted on "actual cost" to the petitioner's detriment in the amount of approximately $250,000).

The incentive allowance was established by the Health Department as part of a program designed to encourage cost savings; facilities which operate at a cost lower than the average for facilities of the same size in the same area receive a portion of that cost-savings as an incentive. Facilities are thus encouraged to avoid passing through excess costs to the State for reimbursement, thereby benefiting the State—as well as the individual facility.

Since Split Rock was a cost-efficient facility, it received an incentive allowance of approximately $90,000 in 1972. Nevertheless, many years later, the Department arbitrarily took back that allowance and has refused to return it—despite the finding of its own hearing officer.

The second issue—whether the facility was entitled to be reimbursed during 1972 and 1973 according to "group average" instead of "actual cost"—involves a determination of the proper "cost" basis for reimbursing newly opened facilities which have limited or inadequate historical cost experience. In order to insure that future reimbursement was not based on incomplete and inadequate cost data statistics, until a facility submitted a cost report covering a period of six consecutive months where there had been an occupancy rate of at least 90%, the Health Department required that prospective reimbursement be based on the average costs incurred by comparable nursing homes (the "group average") rather than on the facility's actual costs.

If 90% occupancy was maintained for six consecutive months during the first year of operation, the facility had the option to switch away from "group average cost" to "actual cost" by filing a six month cost report showing the requisite occupancy rate. The option of making that switch belonged to the facility; it was not an obligation.

For the year 1971, the year it opened, Split Rock had an occupancy rate of less than 90%. Moreover, it never filed a six month cost report. It did submit a report at the end of 1971 covering all costs incurred throughout 1971, which revealed an 89.2% occupancy for the reporting period. Accordingly, "group average cost" for 1971 rather than "actual cost" should have been used for prospective reimbursement purposes for 1972 and 1973. The Department, however, utilized actual costs for 1971—which were lower than the group average—costing the facility more than $250,000.

The Evidence at the Hearing.

Incentive allowance.

Ms. Estelle Wall, Chief Health Care Fiscal Analyst for the Department of Health, was in charge of the unit that established Medicaid reimbursement rates from 1970 through 1974 (Wall: 97-98).* Mr. Terry Opela was responsible for examining reports submitted by nursing homes to the Department of Health and for applying certain ceilings and limitations to arrive at the reimbursement rate (Opela: 232; Wall: 102).

Ms. Wall and Mr. Opela explained that nursing homes were given an "incentive"—an additional sum of money or other increased amount of reimbursement—if they operated below the group average and without significant operating deficiencies (Wall: 140-41; Opela: 246). Group average was determined by grouping nursing homes according to size, geographical area and other factors, and arriving at an average cost for comparable services incurred by nursing homes in the group (Opela: 235-36).

The Significant Operating Deficiency List (S.O.D. list) was made up of homes which surveyors concluded, on the basis of operational inspections, were operating deficiently. The S.O.D. list was prepared by surveyors—not auditors (Opela: 247). Being on the S.O.D. list was the sole basis for depriving a home of the "incentive" (Wall: 141; Opela: 246-47).

Mr. Marvin Kern, Chief Auditor for the Health Department (Kern: 190), confirmed that the official regulations did not authorize elimination of the incentive as a result of

*References are to the Record on Appeal.

audit findings (Kern: 219). According to Ms. Wall the incentive could be eliminated "if the audit shows that there were personal expenses in the [HE-2P] report" (Wall: 101) in accordance with "internal correspondence [which] did not exist during the year in question . . ." (28; see 143-144). But, Mr. Kern could not recall a single instance in which an incentive was disallowed on the basis of an audit (Kern: 219).

Group average versus 1971 costs.

Nursing homes are reimbursed for the services provided to Medicaid patients according to rules established by the Department of Health. The reimbursement is essentially cost-based (Wall: 99-102). Every facility must submit an HE-2P report, setting forth the income received and expenses incurred during the preceding calendar year (Wall: 102, 181). The rates are prospective: costs incurred in or attributable to one year are used to determine the reimbursement rate in subsequent years (Wall: 99, 108).

Since newly opened nursing homes have no history of costs to utilize in setting the rate, Health Department regulations provided that new facilities were to be reimbursed on the basis of "group average" (Wall: 107-108, 125, 167; Opela: 235). However, if a new nursing home had ninety percent or more of its beds occupied for six consecutive months, it had the option of switching its rate to actual costs rather than staying with the group average, depending upon which was more favorable to the facility. The facility made that election by filing a six month cost reporting form which established the necessary occupancy rate for the requisite time periods and by submitting financials (income statements and balance sheets) which were certified by an independent certified public accountant (Wall: 107-108, 126, 128, 170, 186-88; Opela: 236, 238.)

Mr. Sidney Feld, a certified public accountant specializing in Medicaid reimbursement (Feld: 253-54), testified that costs incurred by a facility during its first year were generally "significantly less" than the costs it incurred during subsequent years (Feld: 258-60). That is why first year costs were not used by the Department to determine future reimbursement; group average was used unless the nursing home elected to utilize actual costs (Feld: 257). In short, it was contemplated that new facilities would receive not less than group average rates and might receive higher reimbursement if its actual costs exceeded that average (Feld: 258-259).

Mr. Feld testified that the HE-2P filed by the facility revealed an occupancy rate of less than 90% for the reporting period (Feld: 265).

POINT I.

Split Rock Nursing Home was entitled to an incentive award.

Split Rock Nursing Home qualified for and received an incentive allowance under Health Department regulations in effect in 1972 because the home's costs were below the average costs of other comparable facilities in its grouping. In 1978, the Health Department retroactively revoked that incentive award, claiming that Split Rock did not meet criteria set forth in secret and unofficial internal correspondence created some years later.

The hearing officer restored the incentive because,

> "It was the practice of the Health Department to grant an incentive allowance to those nursing

homes whose rates were below the group average and which are being operated without significant operational deficiencies.

* * * *

"No Health Department regulations were in effect with respect to removal of incentive allowances other than for operating deficiencies. Internal correspondence referred to on this point did not exist during the year in question at this hearing.

"Therefore, it is the feeling of the Hearing Officer that removal of the incentive allowance was improper and it should be restored" (27-28).

The Health Department, however, overruled its own hearing officer. The Department's action was improper and must be annulled.

The official Health Department regulations (10 N.Y.C.R.R. § 86.31) applicable in 1972 provided that nursing homes were entitled to an incentive award when:

"the total cost of administrative, dietary and housekeeping services of an individual facility are lower than the weighted average ceiling of the costs of these services for the group. In instances where the latest survey disclosed significant deficiencies in the operation of a facility, the incentive allowance will not be available."

It is not disputed that Split Rock met the first criterion: its costs were lower than the group. And the evidence adduced at the hearing makes it clear that Split Rock met the

second criterion: it was not on the Department's Significant Operating Deficiency List.

At the hearing, Department employees explained that facilities with significant deficiencies were put on the S.O.D. list; those not on the list did not have significant operating deficiencies. The list was prepared by the local regional office based on survey reports—not on audits of books and records.

Thus, Ms. Estelle Wall, the Chief Health Care Fiscal Analyst for the Department, testified:

> "Q. O.K. Now, Mrs. Wall, are you familiar with the incentive allowance which is granted to certain nursing homes? A. Yes (140).
>
> • • • •
>
> Q. In other words, a facility would receive some sum of money or some increased factor into its rate or some increased amount into its rate if its costs were below a certain level and if it were operating in a certain manner? A. That's right.
>
> Q. And do you remember the term that was in the regulations with respect to when a facility would not be entitled to the incentive allowance? A. I think the term was significant operating deficiencies.
>
> Q. Do you know what a significant operating deficiency is? A. It's been identified by the program people and we accepted the homes that were given to us as having significant deficiencies.
>
> Q. Did you ever hear of anything called a significant operating deficiency list? A. Yes.

Q. And isn't it a fact that certain homes were placed on a significant operating deficiency list? A. Yes.

Q. And those homes that were placed on the significant operating deficiency list were the homes that would not be entitled to an incentive allowance? A. That's right.

And do you know who placed these facilities on the significant operating deficiency list? A. The regional health directors under their auspices.

Q. The health director of the local offices? A. Yes.

Q. Those are the health directors; those are the officers that do the surveys of the facilities? A. Yes" (141-142).

Mr. Terry Opela, a Fiscal Analyst for the Department, confirmed Ms. Wall's testimony:

"A. If a facility was to have operating deficiencies which we call our deficiencies list, then that facility would forfeit the right to any incentive for any particular rate year.

Q. Do you know how it was determined, how the factility was determined to have deficiencies? A. Just generally, our survey people would go in and they were the ones that found the deficiencies. Exactly what the deficiencies were they found, I don't know. All I know is I would get a list saying these homes had deficiencies.

Q. Are you familiar with the term "significant operating deficiency list"? A. Yes.

Q. Do you recollect if a facility would lose its incentive if it were on it? A. Yes.

Q. That was a list that was prepared by surveyors and local regional offices? A. That's right" (246-247).

Split Rock was not on the significant operating deficiency list, and the Department does not contend otherwise. Although the Department alludes to secret internal correspondence which purports to eliminate the incentive if the audit shows that there were personal expenses in the H.E.2P report, that internal correspondence cannot serve as a basis for revoking Split Rock's incentive.*

To begin with, that internal correspondence was not created until some years after the event in question (28; 143-144). It cannot be applied retroactively to govern reimbursement prior to that time.

The power to make administrative rules cannot be applied retroactively. The Court of Appeals explained this principle in *Hecht v. Monaghan,* 301 N.Y. 461 (1954):

> "When dealing with the public, the functions of an administrative agency fall into two broad categories, legislative and judicial. The Supreme Court of the United States drew the line of demarcation between those distinct functions in *Prentis v. Atlantic Coast Line,* 211 U.S. 210, 226, 29 S. Ct. 67, 69, 53 L.Ed. 150, where it said: 'A judicial inquiry investigates, declares, and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. That is its purpose and end. Legislation on the other hand, looks to the future and changes existing conditions by a new rule, to be applied thereafter to all or some of those subject to its power." *Id* at 469.

---

*That correspondence, although mentioned by Department witnesses, was not introduced into evidence.

Accord, Nash v. Brooks, 251 App. Div. 616 (3rd Dept. 1937); *Van Allen v. McCleary,* 211 N.Y.S. 2d 501, 506 (Sup. Ct. Nassau Co. 1961); *City of New York v. Malthie,* 53 N.Y.S. 2d 234, 245 (Sup. Ct. N.Y. Co. 1945); 2 N.Y. Jur 2d, Admin. Law § 32.

Under the rules in effect during 1972 it is undisputed that Split Rock qualified for the incentive allowance. The Health Department should not be permitted to ignore the 1972 rules and resort to internal correspondence created years later to govern what Split Rock was entitled to in 1972. We submit that the Department's attempt to impose new rules long after the event in question is arbitrary, capricious and violative of basic due process.

Furthermore, the internal correspondence violates the official regulations. The official regulations do not permit elimination of the incentive as a result of an audit. They refer only to a survey by surveyors dealing with whether there were significant operating deficiencies.

As Mr. Marvin Kern, the Chief Medical Facilities Auditor for the Department of Health, confirmed:

> "Q. Now, on audit have you ever had the occasion to disallow an incentive allowance? A. Not that I can recall in view of the fact that *that is not an audit function.* The application of the incentive allowance is a rate-setting function" (emphasis added) (219).

But even if it were proper to apply unpublished internal correspondence retroactively, and even if it did not violate official regulations, the correspondence would be without legal effect; to have legal effect, it would have to be filed

with the Department of State as an official rule or regulation to be published officially.

The New York State Constitution mandates that rules and regulations of state administrative agencies be filed with the Department of State. Rules and regulations which are not filed have no legal effect.

Article 4, Section 8 of the Constitution provides:

> "No rule or regulation made by any state department, board, bureau, officer, authority of commission, except such as relates to the organization or internal management of a state department, board, bureau, authority or commission shall be effective until it is filed in the office of the department of state. The legislature shall provide for the speedy publication of such rules and regulations, by appropriate laws."

The Constitutional filing and publication requirements cannot be avoided by labelling a document "internal correspondence":

> "We should not strive to read exceptions into the section or construe it so as to permit the official in charge of the bureau, commission or authority to avoid the necessity of filing by attaching the label "order" or "statement of policy" or some other term to what is essentially a rule or regulation. The spirit and design of the constitutional provision are best effectuated by requiring the administrator, if he wishes the rule and regulations of his agency or department to be effective, to file them no matter what label is assigned to them." *People v. Cull*, 10 N.Y.2d 123, 129 (1961).

Accord, People v. Widelitz, 39 M.2d 51; 239 N.Y.S.2d 707, 710 (Sup. Ct. Bronx Co. 1963).

In sum, the Health Department's determination to revoke Split Rock's incentive award retroactively is without a factual or legal basis and violates due process. Split Rock met the criteria for an incentive set forth in the official rules and regulations. The internal correspondence upon which the Health Department purportedly relied cannot be applied retroactively, is inconsistent with the official rules and their application and was never filed with the Department of State.

Under the circumstances, the conclusions of the hearing officer was correct: the "removal of the incentive allowance was improper and it should be restored" (28).

POINT II.

Split Rock's reimbursement rate should have been based on group average.

While reimbursement is ordinarily based on the costs incurred by a nursing home in prior years, a special rule applies for new nursing homes. For new homes, rates are based on the "group average"—the average cost of comparable services charged to nursing homes of the same size in the same area.

In the instant case, the Health Department has ignored that rule and insisted that Split Rock's rate be based on the costs it actually incurred during its first year, rather than group average. That determination should be annulled.

The Department's determination is based on an erroneous assumption—that the Department could elect to

base the rate on actual costs. This assumption was erroneous for two reasons: (a) the right to elect belonged to the nursing home, not the Department; and (b) Split Rock did not file a six month cost report, and therefore the Department did not have before it a factual predicate for establishing a cost based rate.

The testimony was clear; the right to elect cost based reimbursement was the nursing home's, not the Department's.

Ms. Wall testified:

> "Q. OK. Now why, if you know, was there the possibility for a facility to file a six-month report with 90 percent or more occupancy? A. The facilities filed if they felt that the rate given them based on the average for the group was not high enough. It was called putting them on a cost-based rate, so they filed their own costs in order to establish a cost-based rate" (106; see 170).

Mr. Opela's understanding of the rules was the same:

> "Q. What about during the initial year of operation? What would the rate be based on? A. That would depend upon the facility itself. If the facility filled up at a relatively fast rate, that the facility could go on a cost-based rate, had its cost—had the rates based on the cost that that facility submitted to use and the minimum period that we have that I can remember of setting a rate is three months at 90 percent occupancy or better. Normally it is six months at 90 percent or better.
>
> Q. Who would make the determination? Was that something at the option of the facility?

A. *During that time it was at the option of the facility to submit as cost-based to us . . .*" (236). (emphasis supplied)

Split Rock's accountant, Mr. Sidney Feld, confirmed the testimony of the Department's employees. His knowledge of the applicable rules came from discussions with Health Department officials:

"Q. As a result of those discussions, did you have an understanding of what the proper procedure was? A. Yes.

Q. What was your understanding? A. My understanding was that any period that was less than a calendar year did not have to be certified and the home at its option had a right to present a six-months report if they wanted to change or break other than the group average.

Q. Was it your understanding that during the first year of operation a facility's costs would not be used unless it requested costs to be used? A. That is correct.

Q. And was it your understanding that the manner of the request would be the presentation of a six month report? A. That is correct" (257).

Moreover, Split Rock did not meet the second requirement for establishing a cost-based rate: a report for six consecutive months at 90 percent utilization was never filed. Therefore, the Department did not have a legal basis for formulating a rate based on actual costs.

Split Rock filed an annual report for 1971 which included costs incurred prior to the date it admitted patients, and showed an occupancy rate of 89.2 percent.

When the HE-2P was reviewed, the Department prepared a rate calculation sheet (Exhibit A at the hearing) stating explicitly that Split Rock's 1971 utilization was 89.2 percent (119, 174; Exhibit A at 334). The hearing officer made the same finding—that Split Rock's utilization in 1971 was 89.2 percent (29). But the Department thereafter substituted its own finding of fact, declaring that Split Rock's utilization was 98.4 percent (34)—a finding which has no support in the record and was arrived at by manipulating the statistical data.

The Health Department's determination in 1972—that occupancy was 89.2%—was based on the 365 day period covered by the home's 1971 HE-2P, the only cost report submitted for that year. After the hearing, the Department increased the utilization to 98 percent by reducing the reporting period to 331 days (34).

The Department's belated attempt to raise the utilization above 90% should not be countenanced by this Court. It is inconsistent not only with its own initial determination in 1972, but with the factual determination of its own hearing officer as well. And most importantly, it fails to establish that the requisite 90% was maintained for six consecutive months.

Under the circumstances, since the facility did not elect to be reimbursed on the basis of actual costs during its initial year of operation, the Department has no legal basis for denying group average reimbursement.

CONCLUSION.

The petition should be granted in all respects.

Respectfully submitted,

HOFFINGER, FRIEDLAND & ROTH
Attorneys for Petitioner

JACK S. HOFFINGER
DAVID B. BERNFELD
ROBERT A. GOLDSCHLAG
Of Counsel

May, 1981

Statement Under Rule 5531 CPLR.

1. The Index No. in the court below is 80-517.

2. The full names of the original parties are: Split Rock Nursing Home, Petitioner; The Office of Health Systems Management of the Department of Health of the State of New York, The Hon. David Axelrod, M.D., Commissioner of Health of the State of New York, Richard A. Berman, Director of the Office of Health Systems Management, Respondents. The names have not been changed.

3. The proceeding was commenced in the Supreme Court, Albany County.

4. The proceeding was commenced on or about March 6, 1980, by service of a Notice of Petition and a Petition.

5. Petitioner brought this proceeding to review a determination made by an administrative agency.

6. This is a petition for a judgment pursuant to CPLR Article 78 annulling, vacating and setting aside an order issued by the New York State Department of Health, dated January 30, 1980, after an administrative hearing, sustaining a reduction in the Medicaid reimbursement received by Split Rock Nursing Home. The proceeding was transferred to this Court on May 14, 1980, by order of the Supreme Court, Albany County (Klein, J.) pursuant to CPLR 7804 (g).

7. Review is on the full record, reproduced.

APPENDIX B—Petitioner's Reply Brief.

Argued by
DAVID B. BERNFELD
(30 MINUTES REQUESTED)

NEW YORK SUPREME COURT

APPELLATE DIVISION—THIRD DEPARTMENT

In the Matter of the Application of

SPLIT ROCK NURSING HOME,

Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Mangement,

Respondents.

PETITIONER'S REPLY BRIEF

HOFFINGER, FRIEDLAND & ROTH
Attorneys for Petitioner
10 East 53rd Street
New York, New York 10022
(212) 421-9040

JACK S. HOFFINGER
DAVID B. BERNFELD
ROBERT A. GOLDSCHLAG
Of Counsel

Table of Contents.

Page

Preliminary Statement 3b

POINT. Repondents cannot rely upon an audit report for revoking petitioner's incentive allowance 4b

Conclusion 6b

SUPREME COURT OF THE STATE OF NEW YORK

APPELLATE DIVISION—THIRD DEPARTMENT.

In the Matter of the Application of

SPLIT ROCK NURSING HOME,

Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Mangement,

Respondents.

PETITIONER'S REPLY BRIEF.

Preliminary Statement.

This brief is submitted in reply to some of the arguments made by respondents in their brief to this Court.

POINT.

Respondents cannot rely upon an audit report for revoking petitioner's incentive allowance.

Respondents contend that Split Rock Nursing Home was not entitled to an incentive allowance because the facility had significant operating deficiencies. To support that contention respondents have constructed a new definition of significant operating deficiencies, which is neither reasonable nor rational. Indeed, that definition is contradicted by the testimony at the hearing and is inconsistent with the Health Department's own regulations.

Respondents claim that a significant operating deficiency "relates to the overall conduct of an operator" and includes "the propriety of the information submitted in the HE-2P report * * * as well as the allotment of costs to various categories which may be found to be improper" [Brief at p. 38] and attempt to utilize that definition to urge that a 1975 audit report "disclosed" that petitioner had significant operating deficiencies in 1971. But the testimony at the hearing (quoted at length in our main brief at pp. 10-11) made it clear that significant operating deficiencies have nothing to do with audits, the information contained on the HE-2P, or the allotment of costs. Instead they relate solely to the adequacy of care.

Significant operating deficiencies concern the manner in which the nursing home was operated as revealed by the "latest survey". Thus, 10 N.Y.C.R.R. Part 86.31, provides:

> "Incentive allowance; proprietary nursing homes. Within the rate of payment for proprietary

allowable cost which is equal to percentage established by the Commissioner to represent a sharing in the amount by which the total costs of administrative, dietary and housekeeping services of an individual facility are lower than the weighted average ceiling of the costs of these services for the group. In instances *where the latest survey disclosed significant deficiencies in the operation of a facility,* the incentive allowance will not be available" (emphasis added).

The "survey" referred to is an inspection to determine "the adequacy of care being rendered" by the facility as mandated by Public Health Law Section 2803(1) (effective until March 1, 1978): surveyors seek to determine if the facility is complying with 10 N.Y.C.R.R. Part 700 *et seq. Cf. Massena v. Whalen,* 72 A.D.2d 838 (3rd Dept. 1979). The "survey" has nothing to do with an audit which is an after-the-event review of prior fiscal and statistical records and reports of the nursing home. 10 N.Y.C.R.R. 86-1.8. That is why the Department's Chief Auditor, Mr. Marvin Kern, testified unequivocally that disallowance of an incentive was "not an audit function" (219); rather it is, according to Ms. Wall, the Department's Chief Fiscal Analyst, within the ambit of the professional surveyors (141-42).

The policy considerations which underlie the withholding of an incentive allowance to a facility with significant operating deficiencies is to prevent operators from reducing their costs by reducing the level of care provided to patients. That is why the regulations refer to "survey" and to "the operation of a facility"—and why the S.O.D. list consisted solely of facilities with deficiencies identified and reported by program personnel, not by audit results.

Respondents' attempt at constructing a new definition of significant operating deficiencies is contrary to the evidence and the regulations, as well as common sense, and should be rejected by this Court.

Conclusion.

The petitioner should be granted in all respects.

Respectfully submitted,

HOFFINGER FRIEDLAND & ROTH
Attorneys for Petitioner
10 East 53rd Street
New York, New York 10022
(212) 421-9040

JACK S. HOFFINGER
DAVID B. BERNFELD
ROBERT A. GOLDSCHLAG
Of Counsel

August, 1981